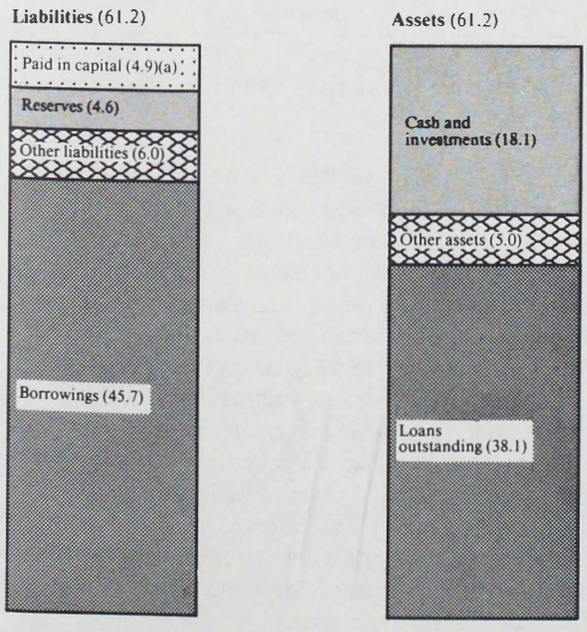
The financial structure and operations of the IBRD

The role of the International Bank for Reconstruction and Development (IBRD) and the question of a future general capital increase have become topical subjects. This article[1] describes the financial structure of the IBRD and in particular the important role of its capital base in determining the scale of its operations.

The IBRD—more commonly called the World Bank[2]—was established following the Bretton Woods Conference in 1944. While the Bank was initially concerned with the reconstruction of post-war Europe, its primary objective over the last forty years has been to encourage the development of productive facilities and resources in the less developed countries. This objective is carried out through the extension of long-term loans, predominantly for specific projects, which are funded largely by borrowings in the international capital markets, supplemented by the Bank's own earnings and the paid-in part of members' capital subscriptions (the Bank is owned by the governments of its 148 member countries). It is a particular feature of the Bank's operations that its lending capacity is determined by the size of its capital base, under a statutory maximum gearing ratio of one to one.

Chart 1
Simplified IBRD balance sheet at end-December 1984



(a) Authorised capital was $78.6 billion; $56.8 billion was subscribed, of which $4.9 billion was paid in and the remainder, $51.9 billion, was callable.

Share capital

The Bank's capital structure consists of authorised capital, subscribed capital and reserves. Authorised capital represents the number of shares which the Board of Governors has authorised to be issued and which member countries have agreed to take up. (In addition, a number of authorised shares are usually unallocated and are available for subscription by new members.) Authorised capital at end-December 1984 stood at $78.6 billion. Subscribed capital represents those shares actually taken up; at end-December 1984 it amounted to $56.8 billion out of the Bank's total equity base (including reserves) of just over $60 billion. Subscribed capital takes the form of partly paid shares, with the unpaid balance subject to call by the Bank and representing a contingent liability for member governments (Chart 1).

The two elements of subscribed capital are commonly referred to as 'paid-in capital' and 'callable capital'. The distinction between these two elements has particular importance for the operations of the Bank.

Paid-in capital

As the name suggests, paid-in capital is that portion of the subscribed capital that is paid to the Bank by its members and is available for use in its general operations. It currently represents around 8% of the Bank's subscribed capital and is a permanent capital contribution funded by member governments; for the United Kingdom this contribution represents part of our aid programme. At 31 December 1984, total paid-in capital amounted to approximately $5 billion.

The paid-in capital is provided cost-free to the Bank (the shares attract no dividends although they do carry voting rights) and, since it is used in the Bank's general operations, it therefore reduces the average cost of funds and, by so doing, contributes indirectly to the Bank's net profits and reserves. Since 1948 the Bank has made a profit in every single year. By the end of fiscal 1984[3] total cumulative profits amounted to $6.3 billion, of which approximately $2 billion has been transferred since 1964 in grants to its affiliate the International Development

(1) This article was written by C J Shelton of the Bank of England's Territorial Division.
(2) References in this article to the Bank or World Bank mean the IBRD, ie excluding the IBRD's two affiliates, the International Finance Corporation (IFC) and the International Development Association (IDA). The IFC and the IDA were established in 1956 and 1960, respectively, to complement the operations of the IBRD, the IFC by promoting the development of the private sector in developing countries and the IDA by lending on highly concessional terms to the poorest developing countries.
(3) The IBRD's fiscal year is the twelve months ending 30 June. Thus the fiscal year 1984 ran from 1 July 1983 to 30 June 1984.

Association (IDA) and the remainder added to reserves. Transfers to the IDA, which are made to assist the funding of concessional lending to the poorest countries, are considered annually but only after the Executive Directors of the Bank have decided how much of its net profit the Bank should add to its reserves.

The sum of the Bank's paid-in capital and reserves—after grants to the IDA—is about $9 billion which, with $45 billion of short, medium and long-term borrowings outstanding, gives a debt to equity ratio (excluding uncalled capital) of 5:1. Reserves have the effect of further reducing the Bank's average cost of funds. The cost of borrowed funds at 30 June 1984 was 8.42%, while the cost to the Bank of all funds (borrowed funds plus capital and reserves) at the same date was 7.44%.

The paid-in portion of capital is divided into two parts. A small percentage is paid in gold or US dollars (this was ¾% under the last general capital increase for which the total paid-in element was 7½%) and the balance in the members' own currencies. It is however open to members to convert national currency payments into US dollars. The amounts paid in gold or US dollars, or subsequently converted by members into US dollars, are freely usable by the IBRD in any of its operations; the remaining amounts in national currencies, referred to as restricted currencies, are usable only with the consent of the respective members. Of a total of $4.5 billion received in national currencies at end-December 1984 some $2.4 billion has been used with such consent.

It is worth noting that the paid-in element of general capital increases, an important factor when the markets come to assess creditworthiness, is not immutable. The Bank has, in fact, been successful in reducing the overall paid-in portion from 20% when it started operations to a little over 8% at present, and without any detriment to its market standing. Such reductions have, however, gone hand in hand with agreements to double the share capital of the Bank, demonstrating continued shareholder support.

Callable capital

Callable capital constitutes the remaining 91.6% of the Bank's subscribed capital. The Bank's callable capital, unlike the paid-in portion, may not be used in its operations for disbursements, or for administrative expenses. It is solely for the protection of its bondholders and can only be used for that purpose. The Bank's Articles of Agreement require that it calls, to the extent necessary, callable capital if it is unable to meet its debt obligations in full out of its other assets. In the event of a call on capital all members would have to meet it up to the full amount of their subscription. Failure by one or more members to honour the obligation to pay would not relieve any other member from its obligation to meet a call. Moreover, if the amount received on a call was insufficient to meet its obligations, the Bank would have to issue further calls until it had the necessary amount to satisfy the obligations. With the addition of $51.9 billion in callable capital, the effective equity base behind the Bank's loan assets rises to $60.8 billion.

An important feature of the Bank's capital is the limit it imposes on the IBRD's lending authority. Under the Articles of Agreement, its outstanding and disbursed loans and guarantees must not exceed its subscribed capital and reserves, ie a maximum gearing ratio of one to one. Risk assets of commercial institutions on the other hand often exceed 15 to 20 times their capital base. Even if the Bank were to borrow unlimited amounts, it could not, under its Articles of Agreement, on-lend those funds once the limit had been reached. At 31 December 1984, the Bank had $38.1 billion of loans outstanding against subscribed capital and reserves of $60.8 billion—a ratio of 0.63 to 1. The Bank's debt to equity and risk assets to equity ratios appear conservative therefore relative to many commercial institutions.

There have been suggestions that the IBRD's gearing ratio should be relaxed. It is difficult to gauge the effect any such change would have on the IBRD. While it would allow an increase in lending authority, it might be construed as a sign of weakening shareholder support and would be

Valuation of capital

In the Articles of Agreement, the capital stock of the IBRD is expressed in terms of 'United States dollars of the weight and fineness in effect on 1 July 1944' (1944 dollars). On 1 April 1978, the Second Amendment to the Articles of Agreement came into force and Section 2 of the Par value Modification Act of the United States was repealed. As a result, currencies no longer have IMF par values, gold was abolished as a common denominator of the international monetary system, and the legal provision defining the US dollar's par value in terms of gold disappeared. There was no longer any basis for translating the term 'United States dollars of the weight and fineness in effect on 1 July 1944' into current dollars or into any other currency.

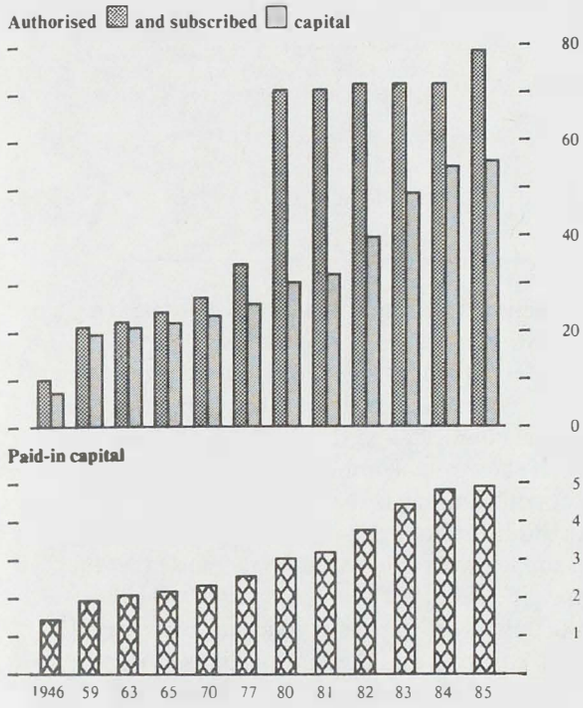
The General Counsel of the IBRD has rendered a legal opinion that, in exercising their statutory power under the Bank's Articles, the Executive Directors may interpret references to 1944 dollars as current US dollars (ie $1.20635), or references to SDRs, as determined from time to time by the IMF. This means that the IBRD's capital and the subscription obligations of each member are measured on the basis of either $1.20635 or the SDR, according to the decision of the Executive Directors on the standard of value. Pending such decision, the Bank has valued its capital stock on the basis of the SDR as computed by the Fund (at end-fiscal year) and expressed it in US dollars. For the time being, payments on account of subscriptions are accepted at the equivalent of $120,635 per share of capital stock.

IBRD capital in current US dollars

$ millions, valued at 1944$1 = $1.20635

	31 Dec.1983	31 Dec.1984
Paid-in	5,650	6,141
Uncalled	57,604	63,817
Subscribed capital	63,254	69,958

Chart 2
History of IBRD capital[a]



(a) At end-fiscal years (ie 30 June) except for 1985 which is at mid-fiscal year (ie 31 December 1984).
(b) Valuation of capital is described on page 48.

regarded as a breach of faith with bondholders. Rating agencies and creditors see the present conservative gearing ratio as a key measure of the political and financial support of the sovereign shareholders. It is possible therefore that an increase in the gearing ratio could make it more difficult for the IBRD to raise funds in the capital markets or, at least, increase the cost of such funds. Such increases in the cost of funds would of course have to be passed on to borrowing members. With such considerations in mind Bank management has firmly stated its opposition to any change in the gearing ratio. The need for a call on the unpaid portion of the capital has never arisen. If a problem ever did arise the Bank has substantial liquid assets, currently over $15 billion, as its first line of defence. In addition there is a considerable flow of funds into the Bank in the form of interest and principal repayments on the whole portfolio of loans outstanding. If any call were ever to be made, it could be paid, at the member's option, either in gold or in US dollars, or in the currency or currencies needed to discharge the obligations for which the call was issued.

Although the callable capital serves as a guarantee for the benefit of holders of the Bank's bonds and other obligations, the Bank itself is operated as if this guarantee were not there. The shareholders guide the Bank's financial policies with a full understanding that their callable capital is at risk but the Bank's operating policies (such as those concerning liquidity, borrowing, reserves and lending) have been formulated so as to ensure that the likelihood of a call on unpaid capital is negligible.

Ultimately, the strength of an institution such as the IBRD must rely on the support given to it by its shareholders. Given the performance of the Bank and the financial commitments its members have made to the institution—in the form of callable capital, paid-in resources, and the fund provided by investors in the member countries—there is every incentive for members both to continue supporting the Bank and to insist on prudent financial policies.

Capital increases

In 1945 the Bank started out with an authorised capital of $10 billion divided into 100,000 shares having a par value of $100,000 each. Increases in authorised, subscribed and paid-in capital have been made from time to time (Chart 2). There have so far been two general capital increases (GCIs) in 1959 and in 1980. Other smaller increases have been made for various purposes such as to allow for entry of new members, to maintain/adjust voting powers or to reflect changes in members' relative economic positions. This last objective has given rise to selective capital increases (SCIs) the most recent of which was agreed by the Executive Directors in July 1984. An SCI usually follows an IMF Quota review and more or less parallels the changes in Fund members' relative positions.

Prior to the approval of the last GCI in January 1980 member governments concluded that the Bank's lending should continue to grow in real terms, and that this required a further increase in capital; the aim at that time was to double the Bank's capital. The paid-in element of the increase was fixed at 7.5% (about $3.3 billion) with the remainder callable. The current US dollar value of the IBRD's capital varies from year to year according to fluctuations in the dollar exchange rate against the SDR (see page 48).

The additions to authorised capital since 1980 have been much smaller, raising the total number of authorised shares by 7,000 to 786,500. This additional capital has allowed the Bank to continue to aim for real growth in its lending programme of nearly 5% per annum. Such a growth rate reflects member governments' confidence in the Bank's effectiveness in helping bring enduring benefit to the economies of the developing countries and in the quality of the Bank's financial and technical assistance. If the Bank is to maintain this growth rate further additions to capital will obviously be required in the future.

Membership and voting power

Voting power in the Bank is determined by the total capital contribution (paid-in and callable) of its member countries. By mid-1947 45 countries had become members of the Bank. Membership has grown considerably since; by the mid-sixties some 100 countries had joined, while present membership numbers 148. The industrial countries provide the bulk of the capital. In particular, the United States initially subscribed more than one third of the Bank's capital, but as new members have joined it has been possible for the US share to be reduced

and it now provides around 20%. The present voting power of the ten largest members (based on full subscription to allocated shares) is shown in Table A, before and after the selective capital increase approved last year. Perhaps the most substantial change as a result of the SCI is that Japan moves up to become the second largest shareholder while the United Kingdom and France share fourth position.

Annexed to this article is a table showing the position at end-December 1984 of all members in terms of capital subscriptions and voting power.

Table A
Voting power of selected members

Percentages of total voting power

	Before selective capital increase	After selective capital increase
United States	20.22	20.01
United Kingdom	5.14	4.76
Federal Republic of Germany	4.59	4.97
Japan	4.58	4.99
France	4.58	4.76
China	3.15	3.09
India	3.09	3.00
Saudi Arabia	3.01	3.09
Canada	2.93	2.92
Italy	2.67	2.78

Reserves and income

The accumulation of reserves has always been a normal part of the Bank's operations. In the early years of its operations the Bank charged a commission on its loans to build up a Special Reserve in liquid form, as required by the Articles of Agreement.[1] In 1964 this commission was discontinued for future loans, but the Special Reserve (of $292 million) remains a part of the Bank's balance sheet. In 1950 the Bank established a further reserve against any possible losses, separate from the Special Reserve. This new reserve was initially called the Supplemental Reserve and since 1976 has been called the General Reserve; until 1964, all the Bank's net income was allocated automatically to this new reserve which, unlike the Special Reserve, can be invested in loans made by the Bank as well as in liquid assets.

In 1964 the Bank started transferring to the International Development Association that part of the Bank's income which was 'not needed for allocation to reserves or otherwise required to be retained in the Bank's business and, accordingly, could be prudently distributed as dividends'.[2]

Both the Special Reserve and the General Reserve are part of the equity shown in the balance sheet. They represent earnings that have been retained in the Bank's business and reinvested, thus creating an excess of assets over the Bank's borrowed liabilities, and afford a margin of protection against losses.

The adequacy of the Bank's reserves is monitored closely, and periodically reviewed by the Executive Directors. Reserves affect the financial strength of the Bank in three different ways. Besides contributing to the margin of protection against loan losses, reserves also contribute, as cost-free resources, to income generation, and have some marginal impact on the Bank's lending authority.

The Bank currently maintains reserves at a level large enough to absorb possible write-offs. Accordingly, the ratio of reserves to loans outstanding is related to the percentage of the loan portfolio judged to offer risks of write-off of loan principal. Currently reserves represent around 10% of the loans outstanding.

The Bank believes that its creditors have not paid a great deal of attention to its reserves in the past, partly because of the absence of loan losses. The prime sources of security looked to by creditors include both the callable capital of the industrial countries and the Bank's liquid assets. The ratio of such callable capital and liquid assets to borrowings outstanding is therefore of interest to creditors. Additions to reserves contribute only marginally however to the level of this ratio, in the sense that they reduce the amount of borrowings required. The level of reserves is unlikely to matter as much as future capital increases in ensuring that the Bank maintains its attractiveness to financial markets. Creditors have, however, paid more attention to the trend in the ratio of reserves to loans in assessing the financial management of international institutions particularly in the last few years when the commercial banks have increased their provisions and reserves. The General Reserve at end-December 1984 stood at $3,716 million.

The Bank's management has recently felt it appropriate to establish an accounting practice for dealing in its financial statements with protracted arrears of interest and principal on loans made by the Bank. It is worth noting, however, that at the end of 1984 arrears represented less than 1% of total debt service payments made to the Bank in the last fiscal year. This perhaps indicates the importance borrowers attach to maintaining relations with the Bank which is a permanent source of development finance at reasonable cost. The Bank lends only to governments, or with a government guarantee; as governments are themselves shareholders they have an interest in the Bank's smooth running. Further, the Bank is the acknowledged leader in the field of loan evaluation, ensuring that investments are economically viable and directed towards high priority areas and that the performance of projects is continuously monitored. Its loan risks are therefore considerably less than those for commercial banks. Nevertheless, there are risks, albeit small, and the accumulation of reserves—as a defence against such risks—is looked upon by investors and rating agencies as a sign of prudent management.

Liquidity and investment income

A further important source of funds for the Bank is the investment income it receives on its substantial liquid

(1) Article IV Sections 4(a) and (b).
(2) Resolution No 208 of the Board of Governors, adopted 10 September 1964.

assets. The IBRD aims to maintain a liquid position of short-term assets (with a maximum maturity of five years, three months) equal to 40%–45% of its estimated net cash requirements over the next three years. This liquidity policy is designed to ensure flexibility in the IBRD's borrowing decisions and to permit it to meet adequately its cash requirements even if borrowing operations are temporarily affected by adverse conditions in the capital markets. At 30 June 1984 liquid assets amounted to $14,869 million; by end-December 1984 they had risen to $15,845 million. The IBRD actively manages its liquid assets which yielded an average realised rate of return of 9.95% in fiscal 1984 and produced $1,399 million of investment income (turnover is around $200 billion per annum). The yield achieved on such short-term investments fluctuates from year to year and in the previous year investment income of $1,417 million, represented a yield of 12.15%.

The IBRD began a security loan programme in January 1982, under which the Bank lends the securities in its portfolio to primary security dealers and to the United States Federal Reserve System for its open-market operations. Each of these security loans is secured by collateral of at least equal market value delivered to the Bank by the borrower. If the collateral is another security, the IBRD earns a fee on the transaction or, if cash, it earns income by reinvesting this in the money markets. Since 1982 some $44 million has been raised in additional income as a result of these transactions.

Loan charges and repayments

The IBRD's total income for fiscal 1984 amounted to $4,655 million. Of this, approximately one third was investment income and two thirds from charges (interest and other fees) on the IBRD's loan portfolio (Table B).

Total loans at end-June 1984 were $76,366 million of which $8,493 million represented loans approved but not yet effective and $30,032 million was undisbursed. The balance of loans disbursed and outstanding amounted to $37,841 million. The average interest rate on outstanding loans during fiscal 1984 was 8.2%, producing income of $2,962 million. In addition commitment charges were $240 million and front-end fees were $34 million, bringing the total to $3,236 million—an 8.9% rate of return on average loans outstanding. Repayments of principal produced a further $2,544 million.

Borrowed resources (Chart 3)

While the sources of finance mentioned so far are important they represent only a small part of the resources used by the Bank in its operations. Around 90% of the Bank's net cash requirements are provided by borrowing in the international capital markets (Table C). The standing of the IBRD in the markets is thus the single most important element in enabling the Bank to continue its operations and access to these markets is essential for the continued growth of its lending programme. The IBRD, like other multilateral development banks, first

Table B
Statement of income in fiscal year 1984

$ millions

Income		
From loans	3,236	
From investments	1,399	
Other	20	4,655
Expenses		
Interest on borrowings	3,638	
Administration	330	
Other	55	4,023
Operating income		**632**

obtained its Triple A rating largely on the basis of the ratio of its funded debt to the callable capital attributable to its Triple A member governments. As the Bank progressed, its record of sound financial management and its performance began to weigh more heavily in assessments by the credit-rating agencies; it is clear nevertheless that investors will continue to look to callable capital as the ultimate security for their investment.

Sources of borrowing

The Bank sells its securities through direct placements with governments, government agencies and central banks, and in the public markets where securities are offered to investors through investment-banking firms, merchant banks or commercial banks. Of the 94 medium and long-term borrowing operations during fiscal 1984, 71 were public issues or private placements and accounted for $6,502 million or 66% of the total amount of funds borrowed. The balance of medium and long-term issues ($2,072 million) was placed with official sources.

Borrowing instruments

Until a few years ago the Bank borrowed solely through medium and long-term securities at fixed rates of interest. Much of the Bank's outstanding borrowing continues to be in this form. But as the Bank's operations grew, particularly in the late seventies, substantial increases were needed in its borrowing programme. Scope for increasing fixed-rate borrowing was limited and the Bank

Table C
Sources and application of funds statement: fiscal year 1984

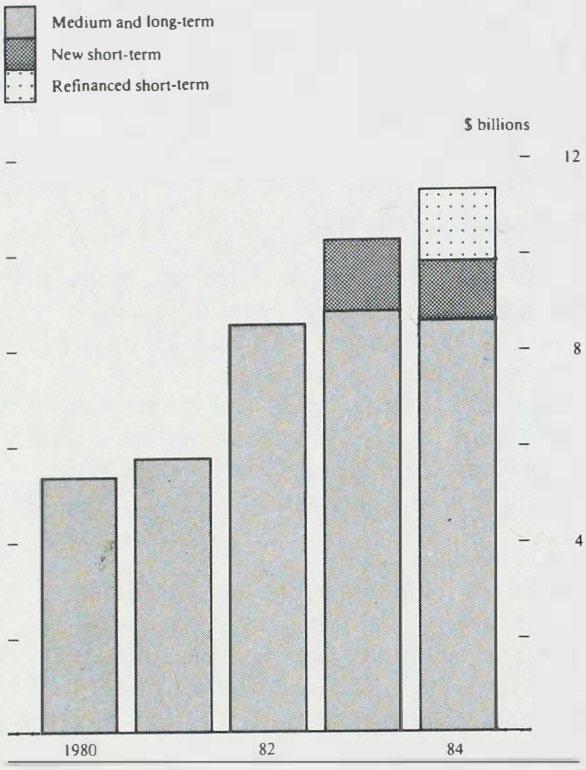
$ millions

Sources		
Cash from operations:		
Operating income	632	
less adjustment(a)	− 72	560
Borrowings	9,762	
less adjustment(b)	−1,637	8,125
Repayments		2,544
Other		389
Total sources of funds		**11,618**
Applications		
Disbursements on loans	8,674	
less adjustment(b)	−2,034	6,640
Borrowings repaid		2,656
Other		1,999
Change in loan portfolio		11,295
Increase in investments		323

(a) As a result of contributions to special programmes, and items not requiring or providing cash (accruals, depreciation, amortization of discounts, premiums and bond issue costs).

(b) As a result of currency depreciations and appreciations.

Chart 3
Borrowing in fiscal years 1980–84



needed to maintain excess capacity in each market to ensure the finest rates. It became necessary therefore for the Bank to diversify by borrowing in new currencies, and in shorter-term and variable-rate markets. Indeed the Bank has established a considerable reputation through its often innovative approaches in developing new borrowing instruments. With a borrowing programme of around $12 billion in the current year the IBRD is overall the largest non-resident borrower in the major markets in which it operates.

During fiscal 1984 the IBRD engaged in numerous currency-hedged transactions commonly referred to as currency swaps and has played a leading role in the development of this activity since 1981. A currency swap is a technique whereby a borrower can use its more extensive access to a particular capital market, say the US dollar market, to obtain funds from another such as the Swiss franc market; this is done either to achieve a better rate than could be obtained by borrowing directly from the second market, or to get around difficulties of access to it. The mechanics are straightforward. The Bank issues a US dollar bond. The dollars received are used to buy Swiss francs in the foreign exchange market at the spot rate. The Bank then enters into a long-term forward exchange contract with a suitable counterparty which has a liability in Swiss francs. The contract at agreed rates of exchange provides for the Bank to make Swiss franc payments, of appropriate size and at appropriate times, to the counterparty in order that the latter may service the original Swiss franc market borrowing; in return for these Swiss franc payments the counterparty makes US dollar payments to the Bank in order that it may service the original US dollar market borrowing.[1] In fiscal 1984 the Bank completed 44 currency swap transactions totalling $1,299 million; $893 million was swapped into Swiss francs, $306 million into deutschemarks, $59 million into Netherlands guilders and $41 million into Austrian schillings. The total value of currency swaps undertaken by the IBRD up to end-June 1984 was $3,788 million.

Swaps have enabled the Bank to increase its access to low-nominal-cost currencies beyond what would have been available through direct borrowing operations. Between fiscal years 1982 and 1984, the Bank was able to swap out of currencies with an average nominal interest rate of 12.9% into currencies with a nominal rate of 7.3%. Swaps have also enabled the Bank to broaden the base of its direct borrowing operations into capital markets and currencies that might otherwise have been prohibitively expensive. For example, swap opportunities were an important consideration in deciding during 1984 to borrow in the ECU market for the first time and to resume borrowing after many years in the Canadian dollar market.

New instruments

In August 1982, the Executive Directors authorised a new short-term borrowing programme, with a $1.5 billion ceiling on notes outstanding; the notes could have maturities of up to one year. The objectives were greater flexibility by gaining access to the growing US domestic market for short-term instruments, and cheaper funds. The Bank's first short-term notes were sold in the US market on 29 September 1982 and the ceiling was reached within a month. These notes have been widely accepted and have been sold and traded within the price range for the highest quality short-term securities. The Bank's average cost for short-term note borrowings was about 2.5 percentage points lower in fiscal 1983 than the cost of the planned alternative—medium-term US dollar borrowings—and in fiscal 1984 it was 2.9 percentage points lower. The initial ceiling on notes outstanding has been increased and at 31 December 1984 stood at $2 billion.

In fiscal 1984 the Executive Directors authorised a $750 million central bank facility designed to accept funds with a one-year maturity from official sources, in particular, central banks. This facility has also proved successful, being fully subscribed soon after the Bank started accepting deposits in January 1984. The ceiling on it has been increased subsequently and at 31 December 1984 outstanding deposits totalled a little over $1 billion.

Lending terms

The Bank makes loans usually with maturities between fifteen and twenty years depending on the economic position of the borrower (guidelines are based on GNP

(1) For more details of the World Bank's currency swap operations see Christine Wallich's article in *Finance and Development*, June 1984, published by the IMF and World Bank.

per capita). There is normally a grace period of between three and five years before principal repayments begin. Prior to July 1982 interest on each loan was at a fixed rate over the term of the loan; the lending rate was set half-yearly and applied to loans approved during the following six months. Interest on loans made since 1 July 1982 is variable and is again adjusted half-yearly. The rate is broadly based on the average cost of a pool of the Bank's borrowings plus a margin, currently 0.5%, to contribute towards administrative expenses and net profit: there is also a commitment fee of 0.75% on undisbursed balances. Typically a project loan will be drawn down over a period of five to seven years. Payments from the loan account are usually made against evidence that goods or services in connection with the appropriate project have been procured.

As drawings under a loan are made over an extended period, and because loans are not fully funded at the time of commitment, the Bank is unable to agree at the time of loan approval the actual currencies to be used. So the Bank agrees to lend in various currencies, up to the US dollar value of the loan, and the borrower is obligated to repay the amount of each currency disbursed. The actual currencies disbursed on a loan and the order in which the currencies will be recalled is at the Bank's discretion. The Bank is obliged to pass on to its borrowers the same currencies that it borrows and to pass on the associated exchange risks;[1] diversification in the currencies in which the Bank borrows, and concern about resulting exchange risks faced by individual borrowers, led the Bank to introduce in 1980 a currency pooling system designed to equalize the effect of exchange rate changes among borrowers. The new system is effectively an accounting procedure which seeks to achieve a more equal distribution of exchange risk by charging all currencies to a central disbursement account (the 'pool') rather than to individual loan accounts. Each loan is in turn charged with a *pro rata* share of the aggregate exchange adjustment that occurs in the pool. Pooling does not isolate borrowers from the effects of exchange rate changes but merely ensures they are all treated as equitably as possible.

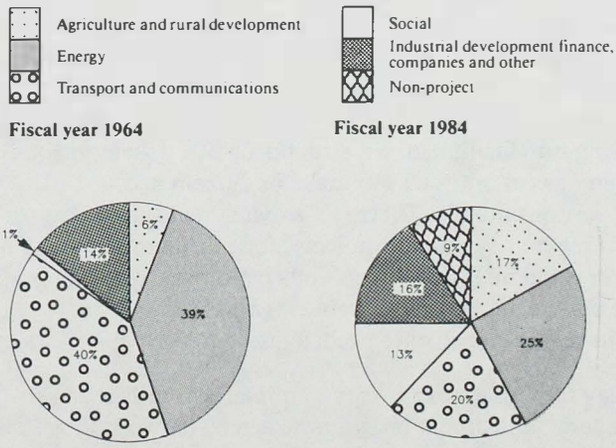
The change to variable-rate lending in 1982 was made essentially for two reasons. First, the growth in lending by the Bank had increased its borrowing requirement sharply in fiscal 1981 and 1982, and an overall deterioration in private capital market conditions meant that the cost of borrowing rose to 9% in fiscal 1981 and 11% in fiscal 1982 (compared with 6½% in fiscal 1979 and 8% in fiscal 1980). Moreover, the Bank began borrowing on a scale that required it to tap all major markets more or less continuously; thus the flexibility that had enabled the Bank to avoid locking into unduly expensive long-term funding was substantially eroded. Short-term or variable-rate borrowing offered an opportunity to compensate for this loss of flexibility in sources of borrowing. While this approach would also expose the Bank and its borrowers to the risk that rates might rise, the existing borrowing policy prevented the Bank from reflecting judgements about the possibly temporary nature of high interest rates in its financial operations. A change in the borrowing practices of the Bank on any substantial scale made compensating changes in Bank lending rate policy necessary.

Second, even if there had been no change in borrowing practices, the lending rate practice prior to July 1982 generated serious fluctuations in IBRD net income. Because a typical loan is drawn down over an extended period of time the Bank was exposed to the risk, and indeed still is though to a diminishing extent, that interest rates might rise after the loan was committed and the cost of funding the loan could thus be well above the rate charged by the Bank. This risk was perceived to have increased because of increased volatility of interest rates and because of the loss of flexibility in avoiding high-cost borrowings. While the introduction, in early 1982, of a front-end fee helped to offset the immediate reduction in income expected from funding loans at higher interest costs, the adoption of variable-rate lending enabled the Bank to avoid the problem on future loan commitments. Variable-rate lending was also the most equitable method of passing on increased costs of borrowing and of avoiding painful and disruptive adjustments in charges including commitment and front-end fees. The front-end fee, which was initially set at 1.5%, has subsequently been reduced, and eliminated since January this year, although it may be reintroduced if this becomes necessary.

Types of loan and project assisted (Chart 4)

Until the mid-sixties more than two thirds of the money lent by the Bank went to support projects in the energy (essentially electric power) and transport sectors. The Bank had supported few agricultural or rural development projects, and no lending to the social sectors (population, health, nutrition and education) or for structural adjustment. By the mid seventies the Bank

Chart 4
Sector analysis of IBRD loans



(1) Article IV, 4b (ii) of the Bank's Articles of Agreement states that in the case of loans made with borrowed funds 'the total amount outstanding and payable to the Bank in any one currency shall at no time exceed the total amount of the outstanding borrowings made in the same currency.'

had diversified considerably. Transport and energy, while still important, had fallen as a proportion of new commitments by 20%, and agriculture had grown from 6% in the early sixties to more than 13% by 1974.

This diversification and change in emphasis among sectors has continued. In addition to giving particular attention to social sector projects that can directly benefit the poorest people in developing countries, the Bank has tried to promote employment in the poorest parts of the economy by lending for agriculture and rural development, small-scale enterprises, and urban development. The Bank has also become increasingly engaged in lending to support economic policy reform and to strengthen institutional capacity. There has also been a change in emphasis in the Bank's energy lending since 1975; the large rise in energy prices over the past decade has made the development of domestic sources of energy more important, and while some two-thirds of the energy programme is still in electric power, oil and gas development is also important.

Structural adjustment and policy-based lending
Under its Articles of Agreement, the Bank is required to lend for specific projects except in special circumstances. In practice, non-project lending has been used in four types of special circumstances:

- for the reconstruction or rehabilitation of an economy after a disaster such as a war, earthquake or flood where a quick transfer of external resources is needed to restore normal development activities;
- to import supplies or equipment so that existing production capacity can be used more fully;
- to offset a sudden fall in export earnings in an economy that is critically dependent on a single export item;
- to finance a sharp deterioration in terms of trade resulting from a rapid rise in import prices.

In recent years the Bank has expanded the scope of its non-project lending to include structural adjustment loans. These are intended to help developing countries adjust their economic policies and structure in the face of serious balance of payments problems that threaten their continuing development. The main objective of this lending is to facilitate the restructuring of a developing country's economy so as to make its current account position sustainable. There is a growing realisation that spending money on new projects alone is not enough. For development to progress and economic growth to take place sound economic policies and strong institutional capacity are needed.

It may take up to seven years to implement fully a structural adjustment programme agreed between the World Bank and the borrower. Structural adjustment loans are therefore designed to be part of a series of loans over the period of adjustment. Before a second loan is approved the Bank and borrower will review progress on the programme laid down under the first loan to ensure that reforms are being implemented or to adjust the programme in the light of experience. Performance under each loan is monitored and disbursements, while made quite quickly compared to disbursements on project loans, are normally released in two stages. Typically half of the loan will be disbursed once it becomes effective (ie approved by the Board and any pre-conditions met) and the balance, after a review of progress, six months later.

In practice it has proved difficult to negotiate the comprehensive programmes of adjustment that go with structural adjustment loans. Emphasis has therefore moved towards other types of lending to support policy reforms and institutional changes, albeit more gradually, either through loans to particular sectors or by attaching appropriate covenants in project loans to help bring about change. For example, an agreement may be included to eliminate disparity between domestic and international market prices in a loan relating to an oil exploration or development project. No precise measure of the amount of policy-based lending by the Bank is available but at its broadest it is thought to account for around 30% of commitments (approximately $3.5 billion a year).

Table D
IBRD co-financing operations
Amounts in US$ millions

	Official lenders		Export credit agencies		Commercial banks	
	Number	Amount	Number	Amount	Number	Amount
Fiscal year						
1982	80	2,250	26	1,985	18	2,216
1983	80	1,750	17	2,924	12	1,016
1984	83	1,979	14	974	6	515

Co-financing (Table D)
The World Bank provides on average around one-third of the total cost of each project with which it is involved. The balance is provided by the borrowing member and, in more than a third of the projects, by other co-financiers. The Bank has particularly encouraged lending by these other co-financiers in projects it has prepared and for which it is providing financial assistance. There are three main sources of co-financing: official sources, mainly governments through their bilateral aid programmes and multilateral agencies such as regional development banks; export credit agencies, which either lend directly or provide guarantees or insurance to commercial banks extending export credits; and commercial banks.

In 1983, for example, new arrangements were introduced to increase co-financing with commercial banks. Under these new arrangements the Bank not only makes its own loan for a project, but participates in the parallel commercial loan. Participation may take various forms:

- direct financial participation in the later maturities of the loan;
- providing a guarantee for the later maturities of the loan;

- accepting a contingent obligation to finance the final repayment of a loan with a fixed level of service payments that combine floating-interest and variable-principal repayments. Thus if interest rates rise above the initial rate the Bank will, if required, repay to the commercial banks the outstanding principal on the loan at maturity.

The Bank has also taken steps to encourage co-financing with official sources and more recently with export credit agencies. There are advantages to both lenders and borrowers from co-financing arrangements. As far as lenders are concerned they can be assured that their resources will be supporting projects carefully appraised and monitored by the Bank, and they may feel that the risk in lending to developing countries is reduced; for borrowers, co-financing may widen access to more varied sources of funding and improve the terms on which finance is obtained.

Annex

Statement of subscriptions to capital stock, and voting power: 31 December 1984

Member	Share of capital: Number of shares	Share of capital: *Per cent of total*	Share of capital: Value SDR millions	Voting power: Number of votes	Voting power: *Per cent of total*
Afghanistan	300	*0.05*	30.0	550	*0.09*
Algeria	4,755	*0.82*	475.5	5,005	*0.81*
Antigua and Barbuda	20	—	2.0	270	*0.04*
Argentina	5,831	*1.01*	583.1	6,081	*0.99*
Australia	12,737	*2.20*	1,273.7	12,987	*2.11*
Austria	5,469	*0.94*	546.9	5,719	*0.93*
Bahamas	171	*0.03*	17.1	421	*0.07*
Bahrain	566	*0.10*	56.6	816	*0.13*
Bangladesh	1,242	*0.21*	124.2	1,492	*0.24*
Barbados	519	*0.09*	51.9	769	*0.12*
Belgium	14,008	*2.42*	1,400.8	14,258	*2.31*
Belize	39	*0.01*	3.9	289	*0.05*
Benin	100	*0.02*	10.0	350	*0.06*
Bhutan	9	—	0.9	259	*0.04*
Bolivia	264	*0.05*	26.4	514	*0.08*
Botswana	331	*0.06*	33.1	581	*0.09*
Brazil	10,794	*1.86*	1,079.4	11,044	*1.79*
Burkina Faso	100	*0.02*	10.0	350	*0.06*
Burma	591	*0.10*	59.1	841	*0.14*
Burundi	150	*0.03*	15.0	400	*0.06*
Cameroon	200	*0.03*	20.0	450	*0.07*
Canada	18,438	*3.18*	1,843.8	18,688	*3.03*
Cape Verde	16	—	1.6	266	*0.04*
Central African Republic	100	*0.02*	10.0	350	*0.06*
Chad	100	*0.02*	10.0	350	*0.06*
Chile	1,240	*0.21*	124.0	1,490	*0.24*
China	23,482	*4.05*	2,348.2	23,732	*3.85*
Colombia	1,175	*0.20*	117.5	1,425	*0.23*
Comoros	16	—	1.6	266	*0.04*
Congo	100	*0.02*	10.0	350	*0.06*
Costa Rica	131	*0.02*	13.1	381	*0.06*
Cyprus	788	*0.14*	78.8	1,038	*0.17*
Denmark	5,136	*0.89*	513.6	5,386	*0.87*
Djibouti	31	*0.01*	3.1	281	*0.05*
Dominica	16	—	1.6	266	*0.04*
Dominican Republic	589	*0.10*	58.9	839	*0.14*
Ecuador	368	*0.06*	36.8	618	*0.10*
Egypt	3,444	*0.59*	344.4	3,694	*0.60*
El Salvador	141	*0.02*	14.1	391	*0.06*
Equatorial Guinea	64	*0.01*	6.4	314	*0.05*
Ethiopia	533	*0.09*	53.3	783	*0.13*
Fiji	453	*0.08*	45.3	703	*0.11*
Finland	3,726	*0.64*	372.6	3,976	*0.64*
France	34,260	*5.91*	3,426.0	34,510	*5.59*
Gabon	120	*0.02*	12.0	370	*0.06*
Gambia	53	*0.01*	5.3	303	*0.05*
Germany, Federal Republic	34,347	*5.92*	3,434.7	34,597	*5.61*
Ghana	856	*0.15*	85.6	1,106	*0.18*
Greece	945	*0.16*	94.5	1,195	*0.19*
Grenada	17	—	1.7	267	*0.04*
Guatemala	167	*0.03*	16.7	417	*0.07*
Guinea	713	*0.12*	71.3	963	*0.16*
Guinea-Bissau	27	—	2.7	277	*0.04*
Guyana	579	*0.10*	57.9	829	*0.13*
Haiti	174	*0.03*	17.4	424	*0.07*
Honduras	110	*0.02*	11.0	360	*0.06*
Hungary	4,203	*0.72*	420.3	4,453	*0.72*
Iceland	680	*0.12*	68.0	930	*0.15*
India	23,002	*3.97*	2,300.2	23,252	*3.77*
Indonesia	7,777	*1.34*	777.7	8,027	*1.30*
Iran	1,580	*0.27*	158.0	1,830	*0.30*
Iraq	956	*0.16*	95.6	1,206	*0.20*
Ireland	2,701	*0.47*	270.1	2,951	*0.48*
Israel	1,108	*0.19*	110.8	1,358	*0.22*
Italy	19,842	*3.42*	1,984.2	20,092	*3.26*
Ivory Coast	834	*0.14*	83.4	1,084	*0.18*
Jamaica	446	*0.08*	44.6	696	*0.11*
Japan	40,830	*7.04*	4,083.0	41,080	*6.66*
Jordan	233	*0.04*	23.3	483	*0.08*
Kampuchea	214	*0.04*	21.4	464	*0.08*
Kenya	550	*0.09*	55.0	800	*0.13*
Korea, South	2,947	*0.51*	294.7	3,197	*0.52*
Kuwait	6,451	*1.11*	645.1	6,701	*1.09*
Laos	100	*0.02*	10.0	350	*0.06*
Lebanon	90	*0.02*	9.0	340	*0.06*
Lesotho	362	*0.06*	36.2	612	*0.10*
Liberia	213	*0.04*	21.3	463	*0.08*
Libya	1,951	*0.34*	195.1	2,201	*0.36*
Luxembourg	770	*0.13*	77.0	1,020	*0.17*
Madagascar	219	*0.04*	21.9	469	*0.08*
Malawi	150	*0.03*	15.0	400	*0.06*
Malaysia	4,250	*0.73*	425.0	4,500	*0.73*
Maldives	262	*0.05*	26.2	512	*0.08*
Mali	173	*0.03*	17.3	423	*0.07*
Malta	163	*0.03*	16.3	413	*0.07*
Mauritania	100	*0.02*	10.0	350	*0.06*
Mauritius	678	*0.12*	67.8	928	*0.15*
Mexico	6,360	*1.10*	636.0	6,610	*1.07*
Morocco	2,612	*0.45*	261.2	2,862	*0.46*
Mozambique	272	*0.05*	27.2	522	*0.08*
Nepal	533	*0.09*	53.3	783	*0.13*
Netherlands	15,117	*2.61*	1,511.7	15,367	*2.49*
New Zealand	3,313	*0.57*	331.3	3,563	*0.58*
Nicaragua	91	*0.02*	9.1	341	*0.06*
Niger	100	*0.02*	10.0	350	*0.06*
Nigeria	2,941	*0.51*	294.1	3,191	*0.52*
Norway	2,410	*0.42*	241.0	2,660	*0.43*
Oman	192	*0.03*	19.2	442	*0.07*
Pakistan	2,519	*0.43*	251.9	2,769	*0.45*
Panama	216	*0.04*	21.6	466	*0.08*
Papua New Guinea	246	*0.04*	24.6	496	*0.08*
Paraguay	386	*0.07*	38.6	636	*0.10*
Peru	938	*0.16*	93.8	1,188	*0.19*
Philippines	3,598	*0.62*	359.8	3,848	*0.62*
Portugal	1,324	*0.23*	132.4	1,574	*0.26*
Qatar	949	*0.16*	94.9	1,199	*0.19*
Romania	2,001	*0.35*	200.1	2,251	*0.36*
Rwanda	174	*0.03*	17.4	424	*0.07*
St. Kitts and Nevis	25	—	2.5	275	*0.04*
St. Lucia	29	*0.01*	2.9	279	*0.05*
St. Vincent	13	—	1.3	263	*0.04*
São Tomé and Principe	14	—	1.4	264	*0.04*
Saudi Arabia	11,212	*1.93*	1,121.2	11,462	*1.86*
Senegal	362	*0.06*	36.2	612	*0.10*
Seychelles	11	—	1.1	261	*0.04*
Sierra Leone	150	*0.03*	15.0	400	*0.06*
Singapore	320	*0.06*	32.0	570	*0.09*
Solomon Islands	17	—	1.7	267	*0.04*
Somalia	189	*0.03*	18.9	439	*0.07*
South Africa	3,463	*0.60*	346.3	3,713	*0.60*
Spain	9,135	*1.58*	913.5	9,385	*1.52*
Sri Lanka	2,110	*0.36*	211.0	2,360	*0.38*
Sudan	600	*0.10*	60.0	850	*0.14*
Surinam	162	*0.03*	16.2	412	*0.07*
Swaziland	440	*0.08*	44.0	690	*0.11*
Sweden	7,367	*1.27*	736.7	7,617	*1.23*
Syria	1,233	*0.21*	123.3	1,483	*0.24*
Tanzania	350	*0.06*	35.0	600	*0.10*
Thailand	3,111	*0.54*	311.1	3,361	*0.54*
Togo	150	*0.03*	15.0	400	*0.06*
Trinidad and Tobago	667	*0.12*	66.7	917	*0.15*
Tunisia	373	*0.06*	37.3	623	*0.10*
Turkey	3,408	*0.59*	340.8	3,658	*0.59*
Uganda	333	*0.06*	33.3	583	*0.09*
United Arab Emirates	980	*0.17*	98.0	1,230	*0.20*
United Kingdom	35,376	*6.10*	3,537.6	35,626	*5.77*
United States	123,177	*21.24*	12,317.7	123,427	*20.01*
Uruguay	411	*0.07*	41.1	661	*0.11*
Vanuatu	323	*0.06*	32.3	573	*0.09*
Venezuela	7,560	*1.30*	756.0	7,810	*1.27*
Vietnam	543	*0.09*	54.3	793	*0.13*
Western Samoa	17	—	1.7	267	*0.04*
Yemen Arab Republic	455	*0.08*	45.5	705	*0.11*
Yemen, People's Democratic Republic of the	336	*0.06*	33.6	586	*0.09*
Yugoslavia	1,509	*0.26*	150.9	1,759	*0.29*
Zaire	1,236	*0.21*	123.6	1,486	*0.24*
Zambia	1,151	*0.20*	115.1	1,401	*0.23*
Zimbabwe	817	*0.14*	81.7	1,067	*0.17*
Total	**579,913**	***100.00***	**57,991.3**	**616,913**	***100.00***